

UL v. Certset (Old Bridge)

(1985)

Letter In response to proposal for provision of
Mt. Laurel II housing
+ draft

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THE STATE UNIVERSITY OF NEW JERSEY
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 Campus at Newark

School of Law-Newark • Constitutional Litigation Clinic
 S.I. Newhouse Center For Law and Justice
 15 Washington Street • Newark • New Jersey 07102-3192 • 201/648-5687

February 15, 1985

TO: Carla Lerman
 Jerome Convery
 Thomas Norman
 Carl Hintz
 Tom Hall
 Dean Gaver
 Lloyd Brown
 Stewart Hutt
 Peter Abeles
 Joel Schwartz

FROM: ERIC NEISSER AND JOHN PAYNE
 Co-counsel for Urban League

We write in response to the Proposal for the Provision of Mount Laurel II Housing, prepared by Olympia & York and distributed at the meeting on February 11, 1985, and to the questions posed in Jerome Convery's letter of February 7, 1985, which were discussed at the meeting. We do not purport to present a precise counter-proposal on all points, but rather to indicate the Urban League's general views on the key issues so that the Township Council can discuss and decide on its willingness to proceed with the concept of the nonprofit corporation. If the Township is agreeable to proceeding, we hope that our comments could also provide a framework for intensive and more detailed negotiations by a smaller group representing the key participants.

As we understand it, Olympia & York proposes that it build 2000 low and moderate income units on top of the 10,240 units for which it has previously received approval, or approximately 1/6 of its total units.¹ Of these 2000 units, O & Y proposes that at

1 Although the O & Y proposal often speaks of building a number of lower income units equal to 20 percent of the market units, such a proportion means that the lower income units will equal 16 percent of the total development, which is the way that the Mount Laurel II Court and all other parties and courts in this area have always calculated set-asides.

least 3/4 be sold to a nonprofit corporation for rental to low and moderate income households. The nonprofit corporation would issue tax exempt bonds to finance the purchase of these units after construction, which bonds would be guaranteed by O & Y. The nonprofit corporation would receive a tax abatement and make an in-lieu payment of approximately 2% of the gross rent receipts, and would convey ownership to the Township after the bonds are retired in 30 years. For the remaining 1/4 of its lower income obligation, O & Y proposes that it be able to provide sales units in the moderate price range, or substitute two "least cost" units, affordable to households with up to 120% of median income, for each moderate unit replaced. The nonprofit corporation (NPC) would have no involvement with these units, unless the Town chose to contract with it to provide the affordability and screening controls required by Mount Laurel. O & Y would not be permitted to continue any construction if it failed to produce in any one year lower income units equal to 1/6 of the total annual construction.²

One-sixth set-aside

Because of its interest in obtaining rental, as against sales, units, the Urban League is prepared to accept a set-aside as low as one-sixth of the total development if at least 3/4 of the lower income units produced were rental units. We see no economic or legal reason to consider anything below a 1/6 set-aside. In this connection, we believe it vital that a developer not be permitted to obtain any building permits for further market units if in any calendar year it has not produced lower income units, distributed between low and moderate as discussed below, equal to one-sixth of its total housing production. Similarly, each year's annual production of lower income housing must provide whatever proportion of 1-, 2-, and 3- bedroom units is ultimately agreed upon and may not include housing limited to senior citizens beyond their proportion of the regional population, if further building permits for market construction are to be issued.

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We refer throughout to O & Y because it has submitted a formal proposal. Although Woodhaven has not yet submitted anything in writing, we understand that it is considering matching the O & Y proposal. We, of course, intend our comments and willingness to proceed with such a settlement to apply as well to Woodhaven.

Low-moderate-least cost distribution

Under the O & Y proposal, 1/4 of the lower income units produced could be moderate income sales units, each of which could be replaced by least cost housing. We could accept the concept of least cost replacement housing if "least cost" were defined as housing affordable by households with no more than 100 percent of the regional median income and if the replacement ratio were 2.5 to 1. The reasons for this position should be obvious. The Supreme Court has clearly permitted least cost housing only when it is economically impossible to produce lower income housing. It is clear from the O & Y proposal, which is designed to break even on the total lower income housing package and actually make money on the moderate units, as well as from the many other proposals in other towns for lower income housing, that it is economically feasible to build lower income housing. We would be agreeable to replacement of up to 1/4 of the O & Y fair share only because of the importance we attach to obtaining rental units for the other 3/4. We feel, however, that the replacements must be affordable to those in the income range just above the Supreme Court's definition of moderate and that a substantial number of these clearly profitable units must be provided as compensation for the lost moderate income units.

Of the remaining 3/4 of the O & Y fair share, we would expect the units to be divided 50-50 between low and moderate. This means that only 37 1/2% of the total O & Y fair share would be low income units-- well below the typical 50% and close to the 1/3 level proposed at various times. We also recognize that if unanticipated economic conditions create serious problems for the NPC, it should have the discretion to accept a mix in the rental package tilting more towards moderate income units. It is vital, however, that there be a fixed proportion of low income units beyond which the NPC cannot go. We submit that, in case of financial difficulties, the floor should be a 1/3 - 2/3 low-moderate split within the rental 3/4 of the O & Y package, producing a minimum of 25% low income units from O & Y's entire development under the worst scenario. It will, of course, also be necessary for the parties to agree on a formula or set of conditions that would trigger the NPC's discretion to change the mix from 50-50 to as low as 1/3-2/3, but we leave for a later date any suggestion as to its content. As noted in the last section of this letter, we would also be willing to permit O & Y to produce only 1/3 low income rental units in the second period of development if it completes at least the first 500 lower income units by 1990.

Affordability standards

We believe that the average of the low income rents should be affordable to households with no more than 40 percent of the regional median income and that the average of the moderate income rents should be affordable to households earning no more than 65 percent of the regional median. The rent of each apartment would be determined on an individual basis to assure that no tenant household pays more than 30 percent of its actual income, much as rents for Section 8 housing are now computed. We recognize that the NPC would, therefore, need to have discretion to accept tenants from a screened pool out of first-come, first-served order to achieve the overall average.

Pegging the moderate income average at 65 percent of the median would insure that the entire range of moderate income households (those earning between 50 and 80 percent of median) would be served. This is reasonable, although somewhat lower than the 72 percent suggested by O & Y, both because O & Y anticipates making a very healthy profit on those pegged at 72 percent and because we are agreeing to accept a higher percentage of moderate income units than usual, and to permit substitution of some of them by even more profitable "least cost" units. Placing the low income average at 40 percent of median is important in order to reach a reasonable proportion of the low income population, which is desperately in need of rental housing, and reasonable in light of the heavier proportion of moderate and least cost units.

We also believe that it is vital to peg the average at a reasonably low level because of the proposal for indexing of rents. As we understand it O & Y proposes to have the debt service component of the rents increase by a fixed percentage each year, regardless of the contemporaneous increases in maintenance costs and income. We believe that no more than a 3% annual increase on the debt service component is reasonable. Even at that level, however, there is a real, though undefinable risk, that the combined effect of that increase and increases in the maintenance and utility components of rent will outstrip annual increases in median income. If we are to accept the risk of rent increases over income gains, we must be sure that rents are initially pegged at a rate that will insure they remain affordable to the target population.

Nonprofit Corporation

We wholeheartedly endorse the concept of a nonprofit corporation as an innovative attempt to finance lower income housing through the marketplace. We recognize the importance of providing the corporation with discretion to adapt its policies

to meet unanticipated financial conditions and satisfy its bond obligations. For example, we recognize the possibility that the corporation might find it helpful to buy some least cost or market level units in order to obtain a larger rental flow to meet its outstanding bond debt. We would, however, have very serious reservations about allowing any such purchases to be credited towards either O & Y's or the Township's fair share. In any case, it is clear that if such credits were to be possible, the Urban League would, contrary to what is discussed below, have to insist upon majority control over the NPC's board of directors to prevent emasculation of the Court's mandate through substitution of market units.

Turning to the issue of control of the NPC, we recognize the legitimate interests of the Township and the developers, as we know the other parties recognize our interest in insuring that the fair share already settled upon is actually built and is affordable to the target population we represent. We believe that far more important than the precise breakdown of the Board of Director membership is the specification of the corporation's discretion in legally binding terms. Specifically, we anticipate that the key parameters on cost, affordability, low-moderate income breakdown, and the like, discussed in this letter, would be included in the NPC's articles of incorporation as well as in an enforceable Court Consent Decree and that appropriate restrictions would also be placed in covenants running with the properties. Assuming that such legal definitions and constraints are in place and that the NPC is not authorized to count market unit purchases against the fair share, we could accept the concept of a Board of 7 with 3 members appointed by the Township, 2 by the Civic League of Greater New Brunswick, and 1 each by O & Y Old Bridge Development Corp. and Woodhaven Village.

Cost of units sold to NPC

Throughout Mount Laurel litigation to date, it has been assumed that the lower income units would be provided at a loss which is compensated for by the expanded profits created by additional market units permitted through higher densities. Because we recognize that the developers here are not seeking significantly higher densities and that the market units will be less expensive than many others built under other Mount Laurel programs, we are prepared to accept the idea that the NPC should pay the actual cost of the total lower income rental housing package and that the developers therefore break even on that aspect of the project. Obviously, however, it is crucial to define "cost" very carefully. We believe that "cost" properly and fairly includes only 6 of the elements included in O & Y's calculations. These elements are:

1) construction costs. In this regard, we believe that the 1-bedroom units should be planned for 560 square feet, the 2-bedroom units for 750 square feet, and the 3-bedroom units for 990 square feet, approximately 10 percent less than the figures used on Table 3 of O & Y's most recent submission. Units of these sizes were approved by the Court in the Bedminster settlement.

2) up to an additional 5% of the above figure for documented unanticipatable contingencies;

3) fees owed to the state or county. We believe that, as part of the municipal contribution, the Township and the MUA should waive all fees for the lower income units;

4) the hard costs of site and tract improvement;

5) a 10% addition for overhead and administration; and

6) seller's actual closing costs.

In addition to eliminating municipal fees, we do not accept O & Y's proposal to include the cost of land, as that cost was already factored into its approved development for 10,240 market units and there will be no additional land costs for the 2000 lower income units. Finally, of course, we have removed the 10% profit category, which we find an incredible suggestion in the context of Mount Laurel units sold to a nonprofit entity, especially when the developer estimates it will make some \$14,000 profit on each moderate unit. Based on the above definitions, we believe that the cost for the 1-bedroom unit, listed by O & Y as \$41,000, would actually be closer to \$30,500, that the cost for 2-bedroom units would be approximately \$36,500, rather than \$48,850, and that the cost for 3-bedroom units would be around \$44,500 rather than \$57,188.

We anticipate that the NPC would purchase each year's production of lower income units at overall cost, as defined above, assuming it could meet its income mix goals at the prevailing interest rate. To the extent that is not feasible, the NPC would have two options. First, it could buy a reasonable number of the least cost or market units in addition to the lower income production, in order to provide itself with sufficient rental income flow and to help the developers break even. Alternatively, if that is not feasible, the NPC would be entitled to purchase the year's production at the highest price it could afford, even if below total actual cost. In the latter case, we would be agreeable to having the NPC provide the developer with a credit that could be used in future years if the bond interest rate or other variables would permit the NPC to afford above-cost prices. The details of these options need work, of course, but we are confident that provisions can be agreed upon to insure both the NPC's viability and the developers' receiving payment for overall costs.

Fair share credit and timing

As stated at the February 11 meeting, the fair share number of 2131, previously agreed upon and incorporated into the Consent Order, is not subject to any further negotiation. On the other hand, we fully recognize that given the complexities of the proposed projects and of the NPC concept, and the realities of the market, the entire 2131 units of the Township's fair share through 1990 will not be completed by 1990. Based on the estimates of annual production mentioned at earlier meetings, we would be prepared to credit towards the 1990 fair share of 2131 units up to 1/2 of the O & Y development's total projected 2000 lower income units, or 1000 units, if constructed by 1995. Similarly, we would consider credit of half of Woodhaven units if it were to adopt the O & Y approach as outlined here. There would have to be some mechanism for insuring that reasonable progress was being made towards that goal. We recognize that production in the start-up years might not be as great as in subsequent years, but we believe it is essential to define a specific number of units that would have to be constructed by 1990 if subsequent construction to be credited towards this fair share. If that goal were not met, then some alternative mechanism would automatically be invoked to complete the Township's fair share. Alternatively, as an inducement, we would consider a provision that if the developers produce a higher than expected number of lower income units by 1990, for example, more than half of the 1000 projected to be completed by 1995, they could shift the mix of low and moderate units in the subsequent five years to as low as 1/3 - 2/3.

It is important to note that under this approach, not all of the Township's fair share would be satisfied even if O & Y, Woodhaven and Oakwood at Madison all proceeded to meet their full construction potential. The Township would have to propose some mechanism for accommodating the shortfall, whether by additional rezoning with a set-aside or by regulatory controls over existing rental units, for example.

We hope that these comments will assist the Township and the developers in their further deliberations on settlement. We would be glad to make ourselves available in any reasonably productive forum to respond to questions raised by these comments.

FIRST ROUGH DRAFT-

Payne

John and Alan- I have no investment, or even confidence in, the order of the topics. It's how it flowed as I wrote this quick first draft. Let's talk about order, tone as well as content as soon as you've had a chance to review it. Thanks. Eric

FEBRUARY 12, 1985

TO: Carla Lerman

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all points, but rather to indicate the Urban League's views on the key issues so that the Township Council can discuss and decide on its willingness to proceed with the concept of the nonprofit corporation and, if it is agreeable, to provide a framework for intensive and more detailed negotiations by a smaller group representing the key participants.

As we understand it, Olympia & York proposes that it build approximately 2000 low and moderate income units on top of the 10,240 units for which it has previously received approval, or approximately 1/6 of its total units.¹ Of these 2000 units, O & Y proposes that at least 3/4 be sold to a nonprofit corporation for rental to low and moderate income households. The nonprofit corporation would issue tax exempt bonds to finance the purchase of these units after construction, which bonds would be guaranteed by O & Y. The nonprofit corporation would receive a tax abatement and make an in-lieu payment of approximately 2% of the gross rent receipts, and would convey ownership to the Township after the bonds are retired in 30 years. For the remaining 1/4 of its lower income obligation, O & Y proposes that it be able to provide sales units in the moderate price range, or substitute two "least cost" units, affordable to households with up to 120% of median income, for each moderate unit replaced. The nonprofit corporation (NPC) would have no involvement with these units, unless the Town chose to contract with it to provide the affordability and screening controls required by Mount Laurel. O & Y would not be permitted to continue any construction if it failed to produce in any

¹ Although the O & Y proposal often speaks of building a number of lower income units equal to 20 percent of the market units, such a proportion means that the lower income units will equal 16 percent of the total development, which is the way that the Mount Laurel II court and all other parties and courts in this area have always calculated set-asides.

one year lower income units equal to 1/6 of the total annual construction.

One-sixth set-aside

Because of its interest in obtaining rental, as against sales, units, Urban League is prepared to accept a set-aside as low as one-sixth of the total development if at least 3/4 of the lower income units produced were rental units. We see no economic or legal reason to consider anything below that level. In this connection, we believe it vital that the developer not be permitted to obtain any building permits for further market units if in any calendar year it has not produced lower income units, distributed between low and moderate as discussed below, equal to one-sixth of its total housing production. Similarly, there must be proportional production of 1-, 2-, and 3-bedroom units.

Low-moderate-least cost distribution

Under the O & Y proposal, 1/4 of the lower income units produced could be moderate, or replaced by least cost housing. We could accept the concept of least cost replacement housing if least cost were defined as housing affordable by households with no more than 100 percent of the regional median income and if the replacement ratio were 2.5 to 1. The reasons for this position should be obvious-- the Supreme Court has clearly permitted least cost housing only when it is economically impossible to produce lower income housing. It is clear from the O & Y proposal to break even on the lower income housing package and actually make money on the moderate units, as well as from

the many other proposals in other towns for lower income housing, that it is economically feasible to build lower income housing. We would be agreeable to replacement of up to 1/4 of the O & Y fair share only because of our interest in obtaining rental units for the other 3/4. We feel that the replacements must be affordable to those in the income range just above the Supreme Court's definition of moderate and that a substantial number of these clearly profitable units must be provided as compensation for the lost moderate income units.

Of the remaining 3/4 of the O & Y fair share, we would expect the units to be divided 50-50 between low and moderate. This means that only 37 1/2% of the total O & Y fair share would be low income units-- well below the typical 50% and close to the 1/3 level discussed at various times. We also recognize that if unanticipated economic conditions create serious problems for the NPC, it should have the discretion to accept a mix tilting more towards moderate in the rental package. We believe that the floor should be a 1/3 - 2/3 low-moderate split within the rental 3/4 of the O & Y package, producing a minimum of 25% low from the entire project under the worst scenario. We think it will be feasible for the parties to agree on a formula or set of conditions that would trigger the NPC's discretion to change the mix from 50-50 to as low as 1/3-2/3, but leave for a later date any suggestion as to its content.

Affordability standards

We believe that the average of the low income rents should be affordable to households with no more than 40 percent of the regional median income and that the average of the moderate income rents should

be affordable to households earning no more than 65 percent of the regional median. Pegging the moderate income average at 65 percent of the median would insure that the entire range of moderate income households (those earning between 50 and 80 percent of median) would be served. This is reasonable, although somewhat lower than the 72 percent suggested by O & Y, both because O & Y anticipates making a very healthy profit on those pegged at 72 percent and because we are agreeing to accept a higher percentage of moderate income units than usual, and to permit substitute of some of them by even more profitable "least cost" units. Placing the low income average at 40 percent of median is important in order to reach a reasonable proportion of the low income population, which is desperately in need of rental housing, and reasonable in light of the heavier proportion of moderate and least cost units.

We also believe that it is vital to peg the average at a reasonably low level because of the proposal for indexing of rents. As we understand it O & Y proposes to have the debt service component of the rents increase by a fixed percentage each year, regardless of the contemporaneous increases in maintenance costs and income. We believe that no more than a 3% annual increase on the debt service component is reasonable. Even at that level, however, there is a real, though undefinable risk, that the combined effect of that increase and increases in the maintenance and utility components of rent will outstrip the annual increases in median income. If we are to accept the risk of rent increases over income gains, we must be sure that rents are initially pegged at a rate that will insure they remain affordable to the target population.

(JOHN AND ALAN -- I need some help here. I am unclear whether we are saying that average can go above 40 and 65 if there are years where rental cost increases outstrip income. Let's talk some more after you review this.)

Nonprofit Corporation

We wholeheartedly endorse the concept of a nonprofit corporation as an innovative attempt to finance lower income housing through the marketplace. We recognize the importance of providing the corporation with discretion to adapt its policies to meet unanticipated financial conditions and satisfy its bond obligations. For example, we recognize the possibility that the corporation might find it helpful to buy some least cost or market level units in order to obtain a larger rental flow and thus meet its outstanding bond debt. We do not, however, believe that any purchases of such units should be credited towards either O & Y's or the Township's fair share. It would merely be a mechanism available to help the NPC face temporary financial constraints.

With regard to control of the NPC, we recognize the legitimate interests of the Township and the developers, as we know the other parties recognize our interest in insuring that the bulk of the fair share settled upon is actually built and affordable to the target population we represent. We believe that far more important than the precise breakdown of the Board of Director membership is the specification of the corporation's discretion in legally binding terms. Specifically, we anticipate that the key parameters on cost, affordability, low-moderate income breakdown, and the like, discussed

in this letter, would be included in the NPC's articles of incorporation as well as the Court's Consent Order and that appropriate restrictions would also be placed in covenants running with the properties. Assuming that such legal definitions and constraints are in place, we could accept the concept of a Board of 7 with 3 members appointed by the Township, 2 by the Civic League of Greater New Brunswick, and 1 each by O & Y Old Bridge Development Corp. and Woodhaven Village.

Cost of units sold to NPC

Throughout Mount Laurel litigation to date, it has been assumed that the lower income units would be provided at a loss which is made up for by the profits created by additional market units permitted through higher densities. Because we recognize that the developers here are not seeking significantly higher densities and that the market units will be less expensive than many others built under other Mount Laurel programs, we are prepared to accept the idea that the NPC should pay the actual cost of the total lower income rental housing package and that the developers therefore break even on that aspect of the project. Obviously, however, it is crucial to define "cost" very carefully. We believe that only 6 elements can in fairness be included, eliminating three elements included in O & Y's calculations:

- 1) actual construction costs-- although we believe that the 1-bedroom units should be planned for 560 square feet, the 2-bedroom units for 750 square feet, and the 3-bedroom units for 990 square feet, approximately 10 percent less than the figures used on Table 3 of O & Y's most recent submission. These are the proportions of the units approved by the Court in the Bedminster settlement.

2) an additional 5% on the above figure for documented unanticipatable contingencies.

3) fees owed to the state or county. We believe as its contribution the Township and the MUA should waive all fees for the lower income units.

4) the hard costs of site and tract improvement;

5) a 10% addition for overhead and administration; and

6) seller's actual closing costs.

In addition to municipal fees, we have removed O & Y's proposal to include the cost of land, as the cost was already factored into its approved development of the land for 10,240 market units and there will be no additional land costs for the 2000 lower income units.

Finally, of course, we have removed the 10% profit category, which at least one of Urban League's co-counsel finds an incredibly galling suggestion in the context of Mount Laurel units sold to a nonprofit entity, especially when the developer estimates it will make some \$18,000 profit on each moderate unit. Based on the above definitions, we believe that the cost for the 1-bedroom unit listed by O & Y as \$41,000, would actually be close to \$31,000.

We anticipate that the NPC would purchase each year's production of lower income units at overall cost, as defined above, if feasible given its bond obligations. To the extent it is not feasible, the NPC would have two options. First, it could buy a reasonable number of the least cost or market units in addition to the lower income production, in order to provide itself with sufficient rental income flow and to help the developers break even. Alternatively, if that is not

feasible, because of insufficient bond funds or otherwise, the NPC would be entitled to purchase the year's production at the highest price it could afford, even if below total actual cost. In the latter case, we would be agreeable to having the NPC provide the developer with a credit that could be used in future years if the bond interest rate or other variables would permit the NPC to afford above-cost prices. The details of these options need work, of course, but we are confident that provisions can be agreed upon to insure the NPC's viability and the developers' receiving payment for overall costs.

Fair share credit and timing

As stated at the February 11 meeting, the fair share number of 2131, previously agreed upon and incorporated into the consent order, is not subject to any further negotiation. Likewise, we are not prepared to accept a fair share stretching beyond 1990. On the other hand, we fully recognize that given the complexities of the proposed projects and of the NPC concept, and the realities of the market, the entire 2131 units of the Township's fair share through 1990 will not be completed by 1990. Based on the estimates of annual production mentioned at earlier meetings, we would be prepared to credit towards the 1990 fair share of 2131 units up to 1/2 of the O & Y project's lower income units, or 1000 units, if constructed by 1995. Similarly, we would consider credit of half of Woodhaven units if it were to adopt the O & Y approach as outlined here. There would have to be some mechanism for insuring that reasonable progress was being made towards that goal. Recognizing that production in the start-up years would not be great as in subsequent years, we believe that a requirement that at

least 40% of the 1000 units be constructed by 1990 would be necessary.

If that goal were not met, then some alternative mechanism would automatically be invoked to complete the Township's fair share.

We note also that under this approach, not all of the Township's fair share would be satisfied even if O & Y, Woodhaven and Oakwood all proceeded to meet their fullest potential. The Township would have to propose some mechanism for accommodating the shortfall, whether by additional rezoning with a set-aside or by regulatory controls over existing rental units, for example.

Love & Kisses

SN